

## **Office of the State Controller**

### **Self-Assessment of Internal Controls**

#### **Tax/Payroll Compliance Cycle**

##### **Compliance With the IRS Backup Withholding Requirements**

#### **BACKUP WITHHOLDING:**

The IRC 3406(a) requires payers under certain circumstances to withhold 28% of vendor payments as backup withholding taxes on payments of interest, rents, royalties, commissions, non-employee compensation, and certain other payments. Payments subject to backup withholding are defined in IRC sections 6041, 6041(a), 6042(a), 6044, 6045, 6049(a), 6050A, and 6050N. Backup withholding is required for governments under three circumstances:

1. Backup withholding is required when the agency requests a Taxpayer Identification Number (TIN) from a vendor and one is not provided. The agency must backup withhold on any payments made to this vendor. Once backup withholding begins, the agency must continue to withhold until the vendor provides his/her TIN.
2. The IRS sends the agency a first B Notice (CP2100) and the vendor does not respond within 30 days to the agency's request for certification of the TIN. The agency must begin to backup withhold on any payment made to this vendor. Backup withholding continues until the vendor provides a TIN certified on IRS Form W-9.
3. The IRS sends the agency a second B Notice within a three year period. The agency must begin backup withholding immediately. Backup withholding continues until the IRS notifies the agency to stop withholding. This notification may be an IRS Letter 147C or SSA Form 7028.

#### **IRS CP2100 NOTICES:**

Each year the IRS issues CP2100 Notices for prior year information returns that contained missing, incorrect and/or currently not issued taxpayer identification numbers. Upon receipt of the CP2100, IRS procedures require each agency/recipient to compare their records with the information furnished by the IRS. There are two separate procedures that must be followed depending on whether the CP2100 listing agrees or disagrees with the agency's records.

For account information that **does not agree to the agency's records**, check to see if the correct information was given on the return, if the information was changed after filing, or if the IRS changed the information when processing the return. In these instances, it is not necessary to respond to the IRS, but it is necessary to do the following:

1. If the correct information was not entered on the return, correct the records and include that information on any future returns filed. Do not send a "B" Notice to the payee.

2. If the information changed after filing the return, be sure to include that information on any future information returns filed. Do not send a “B” Notice to the payee.
3. If the IRS changed the information, make note on the agency records and take no further action.

For account information that **agrees to the agency’s records**, the agency must determine whether this is the “first” or “second” time within three calendar years the IRS has sent notification that the TIN is incorrect. Procedures **must** be in place that allow the agency/college to determine whether this is the first or second notification since the procedures to follow are different for each notification.

## 1. First Notice

- a) Send the first “B” Notice, a copy of Form W-9, and an optional reply envelope to the vendor within 15 business days from the date of the CP2100 notice or the date you received it (whichever is later). Date the “B” Notice no later than 30 business days from the date of the CP2100 notice or the date received. The outer envelope must be clearly marked “IMPORTANT TAX INFORMATION ENCLOSED” or “IMPORTANT TAX RETURN DOCUMENT ENCLOSED”.
- b) Allow the payee 30 calendar days to provide a newly signed Form W-9. **Keep this W-9.** Please note, once the IRS has informed the agency that the TIN of a vendor does not match, a telephone call is not sufficient documentation.
- c) Update agency records with the corrected information received from the vendor and include it on any future information returns filed.

## 2. Second Notice

- a) Send the second “B” Notice, a copy of Form W-9, and an optional reply envelope to the vendor within 15 business days from the date of the CP2100 notice or the date you received it (whichever is later). Date the “B” Notice no later than 30 business days from the date of the CP2100 notice or the date received. The outer envelope must be clearly marked “IMPORTANT TAX INFORMATION ENCLOSED” or “IMPORTANT TAX RETURN DOCUMENT ENCLOSED”. **Do not send Form W-9.**
- b) The **vendor must** contact the Social Security Administration (SSA) to have a social security number validated or the Internal Revenue Service (IRS) to validate an employer identification number (EIN).
- c) Allow 30 business days from the date of request to receive either SSA Form 7028, Notice to Third Party of Social Security Assignment from the SSA or a copy of IRS Letter 147C from the vendor.
- d) **Begin backup withholding** on payments made to payees if SSA Form 7028 or IRS Letter 147C is not received within 30 business days. Backup withholding must continue until either validation is received.

## **DEPOSITING AND REPORTING BACKUP WITHHOLDING:**

It is the responsibility of the agency to deposit and report backup withholding. Once funds are withheld, the withholding agent must deposit the money using the same rules as those used for employment taxes. Most deposit situations will require that a deposit be made by the fifteenth day of the following month in which backup withholding occurred. Withheld taxes are deposited in a federal reserve bank using a Form 8109, Federal Tax Deposit Coupon. (Note: agencies on the North Carolina Accounting must follow special depository procedures. Contact the Office of the State Controller for assistance with making your deposit.) IRS Form 945, Annual Return of Withheld Federal Income Tax must be used to report backup withholding. This return is due by January 31 of the following calendar year.

## **MISCELLANEOUS BACKUP WITHHOLDING INFORMATION:**

The Backup Withholding rules apply to taxable grants or agricultural payments reported on Form 1099-G. It does not apply to any other Form 1099-G type payment. Backup withholding rules apply even if the amount is less than \$600 per year.

At the present time the backup withholding rate is 28% of the payment amount.

Once backup withholding has begun, continue to withhold until the payee provides a TIN. Do not refund the amounts withheld before the TIN was provided. Reflect these amounts on Form 1099-MISC. The payee will get credit for the withholding just as employees get credit for the wages withheld from their paychecks.

Failure to withhold will result in a liability for the amount that should have been withheld. Relief of that liability is only by obtaining an affidavit (Form 4669) from the payee stating that the payee included the payment on a tax return. Obtaining a Form W-9 allows withholding to stop (at least until the second B Notice), but does not relieve the liability for missing withholding.

**Office of the State Controller**

Self-Assessment of Internal Controls

**Tax/Payroll Compliance Cycle**

Compliance With IRS Information Return Reporting and Backup Withholding Requirements

Objectives and Risks

Agency \_\_\_\_\_

Year-End \_\_\_\_\_

<u>Objectives</u>	<u>Risks</u>
All transactions reportable for IRS Information Return reporting and Backup Withholding purposes are properly identified, accumulated, and reported to the proper taxing authorities.	<ul style="list-style-type: none"><li>• The tax system of the United States is one of voluntary compliance. If procedures designed to insure compliance are not being followed the fairness of the system could be compromised.</li><li>• Agency may be subject to penalties for noncompliance with IRS information return reporting requirements.</li><li>• Revenue properly reportable to the Internal Revenue Service could be underreported.</li><li>• Revenue properly reportable to the North Carolina Department of Revenue could be underreported.</li></ul>
All calendar year-end Form 1099 Information Return reporting and Backup Withholding procedures are in written form. These procedures have been reviewed by authorized personnel and approved in accordance with established policies and procedures.	<ul style="list-style-type: none"><li>• Inadequate procedures for determining Form 1099 reportable payments and reportable payees.</li><li>• Vendor files contain inadequate information for proper reporting.</li><li>• Change in agency personnel could cause a failure to properly account for and report information returns as required by law.</li></ul>

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Compliance With IRS Backup Withholding Requirements

Control Policies and Procedures

Agency \_\_\_\_\_

Year-End \_\_\_\_\_

**A. Documentation**

Yes No N/A

- \_\_\_ \_\_\_ \_\_\_ 1. Is there a formal plan of organization under which responsibilities are assigned for identifying payees and payments subject to Backup Withholding?

Name of person responsible: \_\_\_\_\_

Title: \_\_\_\_\_

- \_\_\_ \_\_\_ \_\_\_ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent, accurate, preparation of all IRS Forms required for Backup Withholding?

- \_\_\_ \_\_\_ \_\_\_ 3. Does the formal plan identify the specific individuals responsible for determining if the notice received from the IRS is the first or second notification?

- \_\_\_ \_\_\_ \_\_\_ 4. Does the formal schedule have target dates for completing tasks associated with Backup Withholding within the time periods required by the IRS?

**B. Recording and Execution of Transaction and Events**

Yes No N/A

- \_\_\_ \_\_\_ \_\_\_ 5. Has the entity received CP2100 Notices for prior years information returns that contained missing, incorrect and/or currently not issued taxpayer identification numbers?

- \_\_\_ \_\_\_ \_\_\_ 6. Has the entity compared its records with the information furnished by the IRS?

7. If the account information does not agree to agency records, has the agency checked to see if:

\_\_\_ \_\_\_ \_\_\_ a. The correct information was given on the return?

\_\_\_ \_\_\_ \_\_\_ b. The information changed after the return was filed?

\_\_\_ \_\_\_ \_\_\_ c. The IRS changed the information when processing the return?

\_\_\_ \_\_\_ \_\_\_ 8. If the correct information was not given on the return, has the agency corrected its records and included that information on future information returns that may be filed?

\_\_\_ \_\_\_ \_\_\_ 9. If the correct information changed after the return was filed, has the agency included that information on future information returns that may be filed?

\_\_\_ \_\_\_ \_\_\_ 10. If the IRS changed the information when processing the return, has the agency corrected their records?

\_\_\_ \_\_\_ \_\_\_ 11. If the account information does agree to agency records, has the agency determined if it is the first or second notice within three calendar years?

12. If the CP2100 is the first notice received, has the agency in all cases:

\_\_\_ \_\_\_ \_\_\_ a. Sent the first "B" notice, a copy of Form W-9, and an optional reply envelope to the vendor within 15 business days from the CP2100 Notice or date received by agency?

\_\_\_ \_\_\_ \_\_\_ b. Is the "B" Notice dated no later than 30 business days from the date of the CP2100 notice or the date received by the agency?

\_\_\_ \_\_\_ \_\_\_ c. Is the outer envelope clearly marked "IMPORTANT TAX INFORMATION ENCLOSED" or "IMPORTANT TAX RETURN DOCUMENT ENCLOSED"?

\_\_\_ \_\_\_ \_\_\_ d. Allowed the payee 30 calendar days to provide a newly signed Form W-9?

\_\_\_ \_\_\_ \_\_\_ e. Kept the newly signed W-9 for the agency's records and updated records with the corrected information received from the vendor?

\_\_\_ \_\_\_ \_\_\_ f. Begun backup withholding on payments made to vendors who did not respond within 30 business days from the date of the CP2100?

13. If the CP2100 is the second notice received, has the agency:

\_\_\_ \_\_\_ \_\_\_ a. Sent the second "B" notice and an optional reply envelope to the vendor within 15 business days from the CP2100 Notice or date received by agency?

\_\_\_ \_\_\_ \_\_\_ b. Is the "B" Notice dated no later than 30 business days from the date of the CP2100 notice or the date received by the agency?

- \_\_\_ \_\_\_ \_\_\_
- c. Is the outer envelope clearly marked "IMPORTANT TAX INFORMATION ENCLOSED" or "IMPORTANT TAX RETURN DOCUMENT ENCLOSED"?
- \_\_\_ \_\_\_ \_\_\_
- d. Allowed the payee 30 business days from the date of the agency request to receive either SSA Form 7028, Notice to Third Party of Social Security Assignment from the SSA or a copy of IRS Letter 147C from the vendor?
- \_\_\_ \_\_\_ \_\_\_
- e. Begun backup withholding on payments made to payees if SSA Form 7028 or IRS Letter 147C was not received within 30 business days?
- \_\_\_ \_\_\_ \_\_\_
14. Has the entity deposited funds withheld using the same rules as those used for employment taxes (IRS Circular E or IRS Forms 941) and filed IRS Form 945 Annual Return of Withheld Federal Income Tax, by January 31 of the following year?